D.B. INCOME TAX APPEAL NO.04/2002
(Smt. Harshila Chordia Vs. Income Tax Officer)

Date of order : 7.11.2006

HON'BLE MR. JUSTICE RAJESH BALIA
HON'BLE MR. JUSTICE GOPAL KRISHAN VYAS

Mr. Anjay Kothari, for the appellant.
Mr. K.K. Bissa, for the respondent.

This appeal at the instance of assessee is directed against the order of the Income Tax Appellate Tribunal, Jodhpur Bench, Jodhpur dated 31.1.2002 arising out of IT Appeal No.45/(jdpr)/2000 for assessment year 1993-94.

The assessee was appointed as sub-dealer of M/s. Ganesh Automobiles, Udaipur for the sale of Bajaj Scooters and Mopeds in the region. The questions as have been framed at the time of admission of the appeal read as follows :-

(1)Whether the Tribunal was justified in holding that addition of Rs.40,13,000/- u/s 40A (3) of the Act was wrongly deleted by the learned CIT (Appeals) for A.Y. 1993-94 and the case was not covered by the exceptions to S.40A (3) contained in Rule 6DD of the IT Rules, 1962 ?

(2)whether the Tribunal was justified in holding that the addition of Rs.6,98,000/- on account of peak of cash credits was justified in the facts and circumstances of the case whereas the sale of scooters and fact of collection of cash against sale of scooters from the customers and the payment of such cash to the selling dealer M/s

Ganesh Automobiles, Udaipur was not in doubt ?

(3)Whether the provisions of S.40A(3) of the Act read with Rule 6DD were at all applicable to the purchase of goods viz. Scooters and whether the terms 'Deduction for expenditure' in the scheme of S.40A(3) is applicable to the purchase of very goods for the business on a harmonious reading of the scheme of the Act for computation of income under the head Income from Business or profession u/s 28 to 43 of the Act ?]

The aforesaid three questions read together give a picture that the principal question which falls for consideration is that assessee has made certain payments of sale price of scooters/mopeds, which exceeded in each case Rs.10,000/- to the principal agent M/s. Ganesh Automobiles, Udaipur in cash instead of through crossed cheques or Bank Draft and his case fell under Section 40A (3) of the Income Tax Act, 1961 and such payments in cash exceeding Rs.10,000/- were disallowed as deduction from purchases of mopeds/Bajaj Scooters. The Income-tax Officer has held that there were no exceptional circumstances falling under Rule 6 DD existed which could avoid the consequences of the provisions of Section 40A (3).

The CIT (Appeals) on appeal found in favour of the assessee that such circumstances did exist. The CIT (appeals) found that as per the assessee's explanation he had opened a Bank account at Udaipur where the principal Dealership existed with clear stipulation with the dealer that the remittances of

the cash received by him from the customers of such dealer will be paid firstly in the Bank account of the assessee. Singed cheque book was given to the principal dealer so that he could get payment of purchase price from the assessee through cheques with him by withdrawing the amount of sale price from Bank. The CIT (appeals) also found that assessee was only to purchase the vehicles from the principal agent as a sub-dealer and he has no option to buy the vehicles from other dealers. In these circumstances, the CIT (appeals) was of the opinion that assessee has discharged its burden and additions should not be sustained on technical ground, if the principal dealer has retained cash payment with him without routing it through assessee's bank account at Udaipur, whenever such situation has arisen.

On appeal before the Income Tax Appellate Tribunal by the revenue, the Tribunal found that in this case the assessee has proved that the payments are made to the seller and the identity of the payee has also been proved but the assessee is not in a position to prove the existence of exceptional and unavoidable circumstances which would have caused genuine difficulty to the payee in terms of Rule 6DD and sustained the additions made by the assessing officer under Section 40A(3) amounting to Rs.40,13,000/-. The principal reason which weighed with the Tribunal in discarding the explanation

furnished by the assessee notwithstanding the facts that he was receiving the cash from his customers sending it to the principal dealer and he was required to deposit in the Bank and make the payments through cheques when signed cheque book was already delivered to him, which was not found to be factually incorrect premise, solely on the ground that the case of the assessee did not fall in any of the clauses enumerated in the Circular issued by the Central Board of Direct Taxes about the Explanatory Note appended to Clause (j) was to operate as it was existing at the relevant time. The Tribunal has said that the purchaser was not new to the seller; the transactions were made at the place where the assessee had Bank account as he has opened the Bank account at Udaipur; the transactions were not made on the Bank Holiday and therefore, case for exceptional circumstance is not made out.

In our opinion, perusing the provisions of Section 40A (3) along with Rule 6 DD and Explanatory Note contained in the Circular issued by the Central Board of Direct Taxes, which binds all the authorities under the Act, shows that the Tribunal has been led away by considering enumeration of instances in the Circular in which the provisions of Clause (j) under Rule 6DD would operate to be exhaustive of such circumstances and had not been properly understood, its implication.

It may be pertinent to notice that primary object of enacting Section 40A (3) in its original incarnation was twofold firstly putting a check on trading transactions with a mind to evade the liability to tax on income earned out of such transaction and secondly to inculcate the banking habits amongst the business community. The consequence which was provided was to disallow of deduction of such payments/expenses which were not through Bank either by crossed cheques or by Demand Draft or by pay order. This provision has been subsequently amended. Apparently, this consequence was directly related to curb the evasion of tax and inculcating the banking habits. Therefore, the consequence, which befell on account of non observation of Sub-section (3) of Section 40A must have nexus to the failure of such object. Therefore, the genuineness of the transactions and it being free from vice of any device of evasion of tax is relevant consideration which has been overlooked by the Tribunal.

In this connection, the judgment of Hon'ble Supreme Court which needs to be noticed is in case of Commercial Tax Officer & Ors. Vs. Swastik Roadways & anr., reported in (2004) 3 SCC 640. The consequence of non-compliance of certain provisions of Madhya Pradesh Sales Tax Act, which were intended to check

the evasion and avoidance of sales tax were significantly harsh. The Court while upholding its constitutional validity negated the existence of a mensrea as a condition necessary for levy of penalty for non-compliance with such technical provisions required held that “in the consequence to follow there must be nexus between the consequence that befall for non-compliance of such provisions intended for preventing the tax evasion with the object of provision before the consequence can be inflicted upon the defaulter.” The Supreme Court has opined that the existence of nexus between the tax evasion by the owner of the goods and the failure of C&F agent to furnish information required by the Commission is implicit in Section 57 (2) and the Assessing Authority concerned has to necessarily record a finding to this effect before levying penalty under Section 57 (2).

Of course, present is not a case of levy of penalty but the requirement of law to be followed by the assessee was of as technical nature as was in the case of Swastik Roadways (supra) and the consequence to fall for failure to observe such norms in the present case are much higher than which were prescribed under the MP Sales Tax Act. Apparently, it is a relevant consideration for the assessing authority under the Income Tax Act that before invoking the provisions of Section 40A (3) in the light of Rule 6DD as clarified by Circular of Central

Board of Direct Taxes that whether the failure on the part of the assessee in adhering to requirement of provisions of Section 40A (3) has any such nexus so as to invite such a consequence.

This is particularly so, because the consequence provided under Section 40A (3) for failure to make payments through Bank is not absolute in terms nor automatic but exceptions have been provided and leverage has been left for little flexing by making a general provision in the form of Clause (j) in Rule 6DD, which reads as under :

> "Clause (j) of rule 6DD provides that no disallowance under section 40A (3) shall be made where the assessee satisfies the Income-tax Officer that the payment could not be made by way of a crossed cheque drawn on a bank or by a crossed bank draft;
>
> a. due to exceptional or unavoidable circumstances; or
>
> b. because payment in the manner aforesaid was not practicable, or would have caused genuine difficulty to the payee, having regard to the nature of the transaction and the necessity for expeditious settlement thereof,
>
> and also furnishes evidence to the satisfaction of the Income-tax Officer as to the genuineness of the payment and the identity of the payee."

This clause raised many doubts and enquiries as to what shall constitute an exceptional and

unavoidable circumstances within the meaning of clause (j) and that led to issuance of Circular by the Board on 31.5.1977, which is published in Taxmann, Vol. 1, 1988 Edition. Significantly para-4 of the aforesaid Circular shows very clearly that all the circumstances in which the conditions laid down in Rule 6DD (j) could be applicable cannot be spelt out. However, some of them which will seem to meet the requirements of the said Rule are as follows :

a. the purchase is new to the seller; or

b. the transactions are made at a place whether either the purchaser or the seller does not have a bank account; or

c. the transactions and payments are made on a bank holiday; or

d. the seller is refusing to accept the payment by way of crossed cheque/draft and the purchaser's business interest would suffer due to non-availability of goods otherwise than from this particular seller; or

e. the seller, acting as a commission agent, is required to pay cash in turn to persons from whom he has purchase the goods; or

f. specific discount is given by the seller for payment to be made by way of cash.

It was further clarified in para 6 that the above circumstances are not exhaustive but illustrative.

Therefore, in our opinion, the Tribunal was

clearly in error in not travelling beyond the circumstances referred to in para-4 of the Circular and to consider the explanation submitted by the assessee on its own merit.

Significantly para-5 reproduced hereinbelow gives a clear indication that clause 6DD (j) has to be liberally constituted and ordinarily where the genuineness of the transaction and the payment and identity of the receiver is established, the requirement of rule 6DD (j) must be deemed to have been satisfied. Para-5 of the Circular reads as under :

> "5. It can be said that it would, generally, satisfy the requirement of rule 6DD (j), if a letter to the above effect is produced in respect of each transaction falling within the categories listed above from the seller giving full particulars of his address, sales tax number/permanent account number, if any, for the purposes of proper identification to enable the Income-Tax Officer to satisfy himself about the genuineness of the transaction. The Income-tax Officer will, however, record his satisfaction before allowing the benefit of rule 6DD (j)."

It appears that fulfillment of the conditions of para 5 of the Circular has clearly escaped the attention of the Tribunal. The Circular clearly indicates that ordinarily where the Income-tax Officer is satisfied about the genuineness of the transaction and payment and identification of the cash payment is

established, the Income-tax Officer shall record his satisfaction about the fulfillment of the conditions for allowing the benefit of Rule 6DD (j). Apparently, Section 40A (3) was intended to penalize the tax evader and not the honest transactions and that is why after framing of Rule 6 DD (j), the Board stepped into issuing the aforesaid Circular.

This clarification, in our opinion, is in conformity with the aforesaid principle enunciated by the Supreme Court in Commercial Tax Officer & Ors. Vs. Swastic Roadways & Anr., reported in (2004) 3 SCC 640. In this case, there is no dispute about genuineness of the transactions and the payment and identity of the receiver are established. Therefore, the case clearly fell within the parameters of para-4 and 5 of the aforesaid Circular.

Moreover, the list of circumstances stated under para 4 of the Circular being not exhaustive, in terms of the Tribunal's own finding that the assessee was receiving payments in cash from his customers at Kankroli and was to get delivery of vehicles from Udaipur and he has opened a bank account to facilitate the quick transfers of money from Bank to its dealer to satisfy the conditions of Section 40A (3) and that he has left the signed cheque book also in possession of the dealer so that the cash is transmitted in the assessee's bank account and he could receive the

payments through cheques, which are not disputed, it is apparent that the assessee has done all which he was required to do and it is not the finding of the Tribunal that the assessee was purchasing the vehicles from Udaipur and carrying them to Kankroli for the purposes of delivering them to its buyers. On the contrary, the modus operandi of the assessee was accepted by the Tribunal while considering the question of the cash credit that deposit of each receipt of the cash money from its customers separately was not conducive to the type of the business which the assessee was running. Moreover, the assessee and the Principal dealer had stuck a way out by opening a bank account at Udaipur so that neither the payment to principal dealer is delayed because of the bank middleman nor the assessee was required to deposit every receipt from his customers and then draw a cheque and send it to the principal dealer. The one significant factor which is not disputed and which is found to be correct that the assessee was to receive his supplies from the principal dealer who was situated at Udaipur and the dealing was from buyer to buyer. Therefore, making the prompt payments to dealer, the cash consideration received from end purchaser and getting delivery of vehicles for such purchaser by payment of consideration received from him to principal dealer was the modus operandi.

In these circumstances, we are of the opinion that the conclusion reached by the CIT (Appeals) was correct and the Tribunal by ignoring the scope of Clause (j) of Rule 6 DD as explained by the Board's Circular has erred in reversing the finding reached by the CIT (Appeals) on hyper-technical view. We, therefore, allow this appeal and set aside the order of the Tribunal to the extent it sustains the additions of Rs.40,13,000/- under Section 40A (3).

So far as question No.2 is concerned, apparently when the Tribunal has found as a fact that the assessee was receiving money from the customers in hands against the payment on delivery of the vehicles on receipt from the dealer the question of such amount standing in the book of accounts of the assessee would not attract Section 68 because the cash deposits becomes self explanatory and such amount was received by the assessee from the customers against which the delivery of the vehicle was made to the customers. The question of sustaining the addition of Rs.6,98,000/- would not arise.

We, therefore, hold that no addition was required to be made in respect of Rs.6,98,000/-, which was found to be the cash receipts from the customers and against which delivery of vehicle was made to them.

Question No.2 relates to the directions given

by the Tribunal for adjustment of Rs.6,98,000/- found in para-36 to be part of unexplained cash credits in books of accounts of the assessee by the comparative reading of audited and unaudited books of accounts. However, we find that while a categorical finding has been reached in para No.36 and 23. The Tribunal has curiously found that while re-payment of the aforesaid amount after 31.12.1991 would not affect the peak of cash credit but this amount is liable to be considered while considering the assessee's explanation by the assessing officer to whom the issue about the receipt of cash money from the customers and the delivery of the vehicles against such receipts has been remanded back. In our opinion, the two findings are contradictory in terms, if Rs.6,98,000/- could form the part of consideration received from the customers and paid to the dealer M/s. Ganesh Automobiles, it could not form the part of the unexplained cash credit. Therefore, the finding in respect of Rs.6,98,000/- should necessarily depend upon the outcome of the consideration to be made by the ITO in pursuance of the directions issued by the Tribunal and cannot be outrightly rejected at this stage and to that extent the order of the Tribunal is set aside and ultimate decision in that respect would depend on the consideration by the ITO about the issue relating to the unexplained cash credit in the light of the Tribunal's order. Until then no additions in respect of Rs.6,98,000/- or lesser amount can be sustained.

Accordingly, while we set aside the Tribunal's order to the extent it sustains additions of Rs.40,13,000/-, we modify the directions of the Tribunal relating to deleting Rs.6,98,000/- as part of the cash credit and hold that it should also be part of consideration by the ITO in respect of other unexplained cash credit unembellished by any observation made in that regard.

No costs.

(GOPAL KRISHAN VYAS), J. (RAJESH BALIA), J.

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